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THE FUNCTIONS OF FINANCIAL MARKETS FOR THE CAPITALIST ECONOMY

ALL, CAPITAL, DERIVATIVES, FINANCE, FINANCIAL CAPITAL, MARX, MARXISM, ECONOFICTION WORLD MARKET

In contrast to some Keynesian authors who constantly describe of all sorts of dysfunctions of financialisation, in this book we assume rather that the neoliberal model of financialisation and its austerity policies have proven to be a relatively effective strategy for maintaining capitalist hegemony, at least for a certain period of time. Indeed, since the 1970s financial capital has succeeded in mobilising large sums of money and monetary capital on a global scale, of which,

from an organisational and political standpoint, the following factors were responsible: 1) the flexibilisation and restructuring of the banking and financial sector and the liberation of monetary capital movements from state regulation and taxes; 2) the steering and control of monetary capital flows into the financial system; 3) the privatization of parts of state infrastructure and the state security system (Operators of privatised infrastructure often have to borrow or issue shares themselves to finance their activities, and this in turn strengthens the financial system. Privatisation has also massively expanded the range of securities on offer, such as bonds, stocks, etc.. All this can be positive for individual capital, but does not necessarily indicate a positive balance for total capital.); 4) a massive expansion of the credit system, the markets for government bonds and stocks and an enormous increase in the trade in derivatives and the concentration of large sums of money in investment banks; 5) new techniques of capitalisation are emerging with the creation and issuance of derivatives of all kinds; 6) the transformation of the activities of traditional commercial banks is also taking place in this context, and this is leading to new correlations between commercial banks and other financial institutions such as insurance companies and investment banks. The shadow banking system, which is engaged in the intermediation of loans and securities, currently has a trading volume of \$200 trillion annually. This is more than 50 per cent of all worldwide traded assets. The main players are hedge funds, investment banks, pension funds, insurance companies and money market funds. Players that are not traditional banks are granting more and more loans. The procurement of liquidity is favourable here and the restrictions are lower than in the bank-based credit system. Short-term assets are mostly used to finance the portfolios, so there can be a flexible mix of risk profiles and assets with different maturities.

In the shadow banking system, funds are often raised with repo transactions that have a maturity of one day. Repos are contracts under which securities are sold at a certain price in order to buy them back again at a fixed price plus interest. They can also be resold and therefore serve for the creditor as a collateral. The security still belongs to the lender, while the borrower receives all interest payments on the security during the term of the loan. However, the borrower has to pay a risk premium on the security. In good times, repo transactions increase liquidity, the possibility of turning securities into money. As a rule, the trading of repos is carried out by so-called shadow dealers/market makers, but they can also engage in proprietary trading. These market makers can be major banks, clearing houses or investment funds. However, these types of financial intermediaries cannot create credit like private banks, but have to provide their financing in other ways. Shadow dealers therefore need access to the money markets, otherwise they would have to finance the trades with their own capital or take out bank loans. And while the convertibility of bank loans is guaranteed to a certain extent by the state through various collateral mechanisms, in the case of repos it is private mechanisms and collateral, whereby the degree of their security varies. Deposit insurance protects the deposits of private banks to a certain extent, while securities in the repo business are protected by securitised loans or swap transactions (CDSs). The value of the collateral underlying the repos is determined on the market, with prices fluctuating, but a payout at par is still promised. In times of crisis, the price of securities can fall sharply because no buyers can be found, which has led the Fed to set up collateral structures for

the shadow banking system as well. Repo transactions increase liquidity on the financial markets, with government bonds having the highest market liquidity, while other securities can massively fluctuate in price. If the market liquidity of these securities is high, risk premiums increase. Since the market for government bonds is limited, other assets are increasingly used as hedges, which are supposed to be as liquid as government bonds but are not, and therefore have to be hedged by swap transactions.

The safest repos are government bonds, which also have the lowest interest rates and the lowest risk premiums. The level of risk premiums and the quality of the securities used as collateral are decisive here. Repos are used both to hedge risk and to finance risky investments. In the shadow banking system, short-term loans are mostly balanced with long-term liabilities, non-liquid assets are made tradable through securitisation and a flexible system of risks and maturities and hedges are set up. In contrast to commercial banks, lending in the shadow bank system does not create money on deposit, but rather transfers assets and funds through the market. With the help of market makers, capital market-based loans are financed via the money market. Since the Covid-19 pandemic, central banks have once again provided repo facilities to the shadow banking system and thus a security structure.

Sotiropoulos, Milios and Lapatsioras have summarised the development on international financial markets through the following points (Sotiropoulos, Milios and Lapatsioras 2013: 118f.): 1) In order to drive forward comprehensive financialisation in recent decades, new forms of insurance for debts or promises of payment had to be developed. The insurance of debt has become an important process that massively influences the global financial system and its crises. 2) Non-bank systems that operate in the international money and capital markets are largely unaffected by the regulatory restrictions to which traditional commercial banks are subject, and they are also able to lend money at extremely low interest rates. The various strategies of the shadow banks have reduced the profits of commercial banks and thus also changed their accounting procedures. Commercial banks now have to take over certain functions of an investment bank and concentrate excessively on trading in fictitious capital and derivatives. 3) There are new correlations between the technological innovations that are taking place in the “real sector” of the economy and the innovations in the financial sector that affect derivatives and financial services. This creates new market and adjustment imperatives for all possible companies, which are linked to the destruction of traditional technological and economic structures. The securitisation of loans tradable on the financial markets (cf. Hartmann 2015: 72f.) has contributed to the creation of enormous liquidity potential, the reorganisation and unleashing of risks and the dismantling of old banking structures. Securitisation is to be understood as a technology that is used in particular by shadow or investment banks in order to surpass the traditional big banks in competition. In this process, loans and securities are bundled and packaged into a single security and sold on special markets. Through the different ways in which financial markets function, financial capital continues to differentiate itself in terms of sectors, areas of power, instruments and technologies. 4) The so-called deregulation of the financial markets involves the removal of certain restrictions on certain owners and on the movement of capital, on price and access controls to the financial markets, and finally, it also affects issues of corporate law; it leads

to the facilitation of trading and manufacturing conditions for derivatives, to free interest rate movements, to the transnationalisation of payment flows and, last but not least, to the establishment of offshore centres largely removed from the control of state authorities. Even in developed economies, the authorities responsible for supervising the financial markets, complex monitoring infrastructures and supervisory organisations have tended to be reduced, where even the Basel control strategies with their capital buffers could not prevent risk assessments and lending from remaining largely in the hands of the private banks. In addition, the balance sheet regulations were liberalised and certain accounting standards were privatised. The liberalisation of financial markets has further led to the expansion of large banks that are highly involved in international transaction chains, making them systemically relevant not only in terms of the scale of their transactions, but also in terms of the connections and nodes they maintain within the networks of the international financial system. 5) The over-the-counter (OTC) markets, the various offshore financial centres and special purpose vehicles (SPVs), the various money and capital markets with their instruments (bonds, securities, swaps, etc.) and the hedge- and investment funds, or, in other words, the general development of the financial regime as a dense network of organisations, together with new regulating activities (liberalisation of contract law),^[1] with which certain organisations are able to circumvent state supervisory authorities, the monitoring of credit practices and other supervision – all this makes the global financial system as a whole much more complicated.

It was states themselves that drove the expansion of the shadow banking system. When government bonds have to be placed on the financial market, they compete with each other for the purchase of their bonds, and they also find buyers in the shadow banking system, which thus remains dependent on government bonds to secure its transactions.

With offshore centres, the governments of the leading capitalist countries grant large financial institutions a legal space separate from the national legal space, making financial capital virtually stateless, which implies the convergence of certain policies, tax avoidance and money laundering of illegally acquired funds that in turn can be transferred in accordance with the rules back to the countries where the investors are headquartered. The worldwide expansion of the financial sector would not have been possible without legal rules, which allow financial institutions to use the laws of their home countries at the international level or, if it is profitable to them, to use foreign law.

Greek economist John Milios claims that processes of financial capital today contribute to an intensification of the competition between companies, no matter what sector they belong to, by improving their mobility, which has the tendency to produce average profit rates and returns and at the same time to realise extra profits by increasing the control of the efficiency of companies. (Milios 2019) The modern financial system constantly generates new normalising procedures of evaluation, calculation and valuation of companies, providing specific representations (theories, data, information, etc.), institutions (analysts, rating agencies) and mathematical methods and models for quantifying capitalisation. These processes include, on the one hand, the capitalisation of securities and derivatives traded on the financial markets and, on the other

hand, new practices of control of capitalist enterprises, aimed at improving their profitability and maintaining capitalist power relations as a whole. A company whose balance sheets, market capitalisation and prices (observed and evaluated in the financial markets), indicate insufficient exploitation, will quickly lose the “confidence” of analysts, rating agencies and, as a result, of investors/speculators, which can lead to restrictions on credit, the threat of hostile takeovers and a reduction in the company’s market capitalisation. The company must minimally then expect more difficult financing opportunities on the financial markets due to the prognosis of its future profitability. For the financial system, this type of correction has the function, among other things, of immediately compensating capitalist investors who are still willing to invest in an endangered company in the future with higher risk premiums for the affirmation of increased risk, corresponding to the deteriorated future economic prospects of the company.[2]

Financial markets today are largely secondary markets, providing a very specific “contribution” to the calculation, evaluation and control of current and especially future strategies of companies, thus reinforcing at the same time the tendency for average profit rates of industrial companies. The function of synthetic financial instruments here is to calculate, insure and regulate efficiency gains and risks, i.e. as with interest rates, their allocative function is precisely to allow money capital flows to flow as rule-compliant and at as high a speed as possible, and to a certain extent to control the investment decisions of the functioning capital. Contrary to Keynes’ assumptions, it is precisely the illiquid market, i.e. the capital that remains tied to factories and machines, that cannot satisfy the effectiveness of fluid fictitious and speculative capital, since capital does not necessarily have to be tied to a certain place for a longer period of time; as the financial markets illustrate, it can circulate constantly as fictitious and speculative capital and look for better possibilities of exploitation. It is precisely the financial markets that generate a fluid structure for calculating the effectiveness of individual capital – they are to be understood as a kind of (fictitious) superintendence of capital movements, so that individual capital must permanently adapt its strategies to the respective requirements of financial markets. It should be noted that the control of companies by the financial system, however efficient it may be, is still a fictitious control, inasmuch as the calculation, prognosis and evaluation of future complex production processes of companies by analysts, rating agencies and financial markets always have to include a multitude of contingencies. But nevertheless, if one prices out the risk, the processes of production and circulation can be further intertwined, whereby the gap between present and future is then further closed. It is precisely the attempt to control these contingencies that requires very specific risk management and condensed economic power. It is important to bear in mind that the place of capital is not occupied by a single subject: on the one hand, the managers or functioning capitalists have an intermediary function, oscillating between the maintenance of factory discipline, which they must permanently supervise, and the recognition of market discipline, which is related to the increase in market capitalisation. On the other hand, it is the money capitalists outside the factories who constantly have their agencies monitor the performance charts of companies. In this context, the organised financial markets exercise a critical function: they reward the profitable and competitive companies and punish those companies that do not produce profitably enough.

Today, it is the major rating agencies that permanently assess the profitability, solvency and prospects of companies on a global level, using specially developed differentiated scales that range, at Standard & Poor's for example, from AAA to D. These ratings have a direct influence on the share and bond prices of companies, and in the case of the latter, on the ability of companies to pay interest on bonds and to repay the bonds themselves at maturity. This is the evaluation of the capitalisation of promises to pay, which are represented in the prices and the level of interest (risk premiums) of companies. In this context, the rating agencies are to be understood as information machines that produce an ideological, mathematical and standardised knowledge that can be accessed today by certain market participants worldwide, which in turn has a disciplinary effect on the companies themselves, which now have to comply with certain standards in their business organisation, for example timely accounting, documentation of solvency, quarterly reports, management strategies, valuation of loans, etc. Companies can only survive on the financial markets if they permanently submit to these ratings and can demonstrate sufficient creditworthiness in terms of transparency, economic efficiency and profitability. The focus is less on the company's past and more on its future prospects of success. If a company is downgraded in its ratings, it must expect higher interest rates on loans and price markdowns on its bonds. The three major private rating agencies (Moody's, Fitch and Standard & Poor's) are paid by the companies themselves for their credit ratings, so that they receive the standardised evaluations of the business management information of their own companies, which on the one hand subjects them to further disciplining, and on the other, opens up new prospects of success if the ratings are good. Today, globalised financial transactions of companies are hardly conceivable without these ratings. The international community of investors can now easily compare a company in Japan with one in Canada in order, according to the future prospects of success of both companies, to invest or not.

Holders of bonds and shares are particularly interested in the short-term calculated profitability of companies, which increases the pressure on their management to increase productivity and profitability immensely. If a company is dependent on financial markets and their instruments, methods and valuations with regard to its financing, then the suspicion of an inadequate realisation, both now and in the future, even if it may be unfounded, increases the costs of its financing, lowers its share and bond prices and thus reduces its economic power for manoeuvre overall. (Sotiropoulos, Milios and Lapatsioras 2013: 153) A company's workers are then also exposed to economic restrictions, and they may face the dilemma of having to accept less favourable outcomes in the collective bargaining process or, through a militant standpoint, having to force the company into bankruptcy or a takeover. For workers, the latter option is almost always associated with a violent restructuring of their own working and living conditions. For the workers, it is therefore a question of accepting the power of capital unconditionally or of surviving with greater insecurity or even falling into unemployment. Thus, financialisation promotes and accelerates the need to restructure capitalist production processes, and as a result, today we are witnessing longer working hours, greater labour intensification and more layoffs, while workers' demands for real wage increases are continually being silenced due, of course, to the strong fragmentation of the working class, the dissolution of the classical factory

and the phenomenon of transversal precarisation.

The concept of shareholder value, which provides the short-term maximisation of a company's profitability and, accordingly, the short-term sale of its insufficiently profitable parts of the company and, in addition, constant internal restructuring, creates a flexible mechanism by which the operational logic of financial capitalisation penetrates the organisational structure of the companies themselves, forcing them to adapt, adjust and restructure on a permanent basis. (Windolf 2017) Speculative capital can now abstract in a certain way from the body of the enterprise (it is now a purely quantitative expansion of capital) and at the same time search in the balance sheets for hidden profit opportunities in the company, for "values" that can be monetised but are not yet reflected in the share price. The shareholder value is the ratio of the derivative when it affects the environment of the company. The share price is the derivative, while the company is the underlying. The options on the share price are in turn a derivative on the derivative. The derivative ratio includes also phenomena such as the increasingly rapid change in the so-called core business of companies when they no longer meet the return expectations of their owners. The threat of hostile takeovers is also one of the strategies of financial capital, whereby takeovers are profitable for investment funds precisely when the value of the company is lower than its market capitalisation. It is then possible to offer to the shareholders of the company higher prices when they buy their shares, in order to gain control of the company, restructure it and sell individual divisions, or the company as a whole, profitably. This must also be seen as an attack on the management of a company, although it usually remains a threat of a hostile takeover because managers have long known that if they violate certain mechanisms prescribed by financial markets, they can expect the share-prices of their companies to fall and thus become victims of a hostile takeover. (Ibid.) These rather virtual threats, which are countered by far fewer actual takeovers, nonetheless unfold a comprehensive global disciplining of companies.

The permanent "control" of companies by financial capital also includes their molecular evaluation of the performance flows at the internal management level, and this is done systematically through the use of mathematical and stochastic models based on algorithms that aim at evaluating and optimising particular procedures used within the company's production processes, in order to continue to develop specific strategies aimed at maximising short-term profits. The software Enterprise Resource Planning (ERP), which is to be understood as the operating system of a company, brings together information about warehousing, production and human resources management from databases, whereby not only intra-company interrelationships are objectified and made visible, but the entire supply chain, e.g. of transnational corporations, can be mapped across continents. On the basis of this software, parts of companies can be divested, production locations can be compared and employment hierarchies in the companies can be evaluated. Accounting, i.e. the control of the performance flows in a company itself, sets in its strategic handling of figures, new standards for the account departments and bookkeeping. This type of operation or optimisation is practically implemented by using a variety of instruments (algorithms, math and models).

These mechanisms constantly require new forms of organisation within companies themselves, often forming formally independent companies that remain the property of a single financial holding company. Thus, in the wake of the need to realise short-term profits, a rapid shift of investments from the less productive to the more productive sectors of a company seems to be more easily possible, since legally independent sectors can be reduced, enlarged or sold in the short-term. Another strategy is outsourcing, which may also be due to certain technical necessities (for example, when only smaller companies are able to produce innovative products, but as the large companies fuel the competition between them and suppliers, further cost reductions can be achieved that compensate for the declining economies of scale resulting from the fragmentation of production processes). (Porcaro 2015: 30) The management and organisation of companies today is highly dependent on the respective financial holding company, institutional investors and shareholders, who are geared towards short-term profit maximisation and subject the returns on their investments to constant examination. In addition, institutional investors such as investment funds or hedge funds themselves *are subject to* specific controls because their investors are today more willing to withdraw their capital faster and invest elsewhere. Companies and certain parts of companies, which are already highly fragmented and sometimes outsourced for cost reasons, are now effectively capitalised: cost structures, buildings and machinery, the qualifications of employees and workers, technical know-how and especially future prospects of success are subject to constant assessment and evaluation on financial markets. The vertical disintegration of companies, the fragmentation of production processes and the global splitting of production are intensified by the management of the company, which is oriented towards the principle of shareholder value. With the parameter “expected profitability”, the owners permanently put the future reproduction of the company itself at their disposal, whereby current production processes, parts of the company or business areas, wage levels, productivity, work organisation, real estate, research and fixed capital become the object of a very specific cost and profit calculation.

All this can be summarised as follows. The concept of shareholder value implies the financial decisive valuation of companies on financial markets at the same time as a decision on their future suitability as financial investments. Returns on capital are sought in order to reduce the risk exposure of investors and shareholders (plus the so-called performance commitment of managers) with a surplus and at the same time to increase the profitability of companies. While internal parameters such as the individualisation of compensation and distribution systems, flexibility of work, atypical employment relationships, efficiency of knowledge condensed in machines and labour and outsourcing production areas for the company, are constantly adjusted to conquer new business areas in the wake of ever more rapidly changing digital distribution networks (rapid obsolescence of new technologies, permanently aggressive marketing, changing consumer preferences, etc.). In this context, the performance of a stock corporation today always has to attest to the efficient accumulation of fictitious and speculative monetary capital, by taking advantage of the opportunity for structural innovation and potential mobility on the capital markets, in order to reduce dependence on the competitive conditions of one's own industry or to build up oligopolistic structures, which by no means excludes the possibility that innovations

may also be blocked. In addition, large companies in industry or trade are starting to operate on financial markets themselves, so that the profits made may well be higher than in the actual business areas.

[1] Katharina Pistor writes that it is precisely the wealthy asset owners who today claim freedom of contract, without taking note of the fact that these rights are guaranteed by states. International leaders in this encoding of capital, Pistor writes, are the English common law and the law of the State of New York. It is of course no coincidence that these legal systems correlate with the financial centres of London and New York, where the important law firms are also located. (Pistor 2020: 25-26) However, there is no central right of one world state, but powerful and privileged national rights that are linked by certain rules. Transnational corporations then choose the rights most favourable to them.

[2] Bichler and Nitzan argue somewhat differently on this point. They criticise the notion that risks and returns are positively correlated, and instead assume that the correlation is negative: the higher the power of a company, the lower the returns, because power is exercised here through strategic sabotage and this will cause resistance. Moreover, stock markets do not develop pro-cyclically. Stock prices will only move in the same direction as current profits if the market expands massively (capitalised power is high); but if profits are moderate or low, then stock market price movements and current profits can hardly be correlated. The countermovement between the stock markets and the underlying economy reflects the sabotage of capital accumulation, i.e. financial investors do not really care about real capital; they are indifferent to the means of production, to labour and knowledge, even to market efficiency. They are purely interested in financial capitalisation. Even the long-term growth rates of financial capital (stocks and bonds) and the real capital stock (measured in dollars) correlate, for Bichler and Nitzan, only negatively. (Bichler and Nitzan 2013)

taken from the book Financial Capital in the 21th century

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